AMERICAN BANKERS ASSOCIATION ®

1120 Connecticut Avenue, NW
Washington, DC 20036

1-800-BANKERS
www.aba.com

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**Edward L. Yingling**
Executive Vice President
Tel: 202-663-5328
Fax: 202-663-7533
Email: eyinglin@aba.com

2 February 2004

Mr. Jennifer J. Johnson
Secretary
Board of Governors
of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551

Re: Docket R-1167 (Regulation Z)
Docket R-1168 (Regulation B)
Docket R-1169 (Regulation E)
Docket R-1170 (Regulation M)
Docket R-1171 (Regulation DD

Dear Ms. Johnson,

The American Bankers Association ("ABA") is pleased to submit our comments on the Federal Reserve Board's ("Board") proposed amendments to Regulations Z, B, E,M, and DD and their respective Official Staff Commentaries. In addition, the proposal to Regulation Z includes several technical revisions to the staff Commentary.

The proposal makes the form of disclosures consistent among the various consumer protection regulations. Specifically, it adopts the "clear and conspicuous" standard, along with examples, currently contained in the Commentary to Regulation P (Privacy of Consumer Financial Information). While ABA appreciates the Board's stated intention to facilitate compliance and make disclosures more understandable, we believe that the proposals do neither. The proposals are unsuitable and unworkable, and implementation will impose huge costs on the industry. The subjectivity of the proposals will make compliance uncertain and spawn expensive lawsuits without improving the disclosures in any meaningful way. Indeed, in some cases, the disclosures and account documents called for would diminish consumer comprehension.

The ABA brings together all elements of the banking community to represent the interests of this rapidly changing industry. Its membership – which includes community, regional, and money center banks and holding companies, as well as savings associations, trust companies, and savings banks – makes ABA the largest banking trade association in the country.

### *"EXAMPLES" OF "CLEAR AND CONSPICOUS" PROPOSALS*

## *Summary*

The proposals' universal definition of "clear and conspicuous" means "designed to call attention to" and "reasonably understandable." Specifically, under the proposals, "reasonably understandable" disclosures:

- Present the information in the disclosures in clear, concise sentence, paragraphs, and sections;
- Use short explanatory sentences or bullet lists whenever possible,
- Use definite, concrete, everyday words and active voice whenever possible
- Avoid multiple negatives
- Avoid legal and highly technical business terminology whenever possible; and
- Avoid explanations that are imprecise and readily subject to different interpretations

Examples of disclosures that are "designed to call attention":

- Use plain-language heading to call attention to the disclosures
- Use a typeface and type size that are easy to read. Disclosures in 12 point type generally meet this standard. Disclosures printed in less than 12 point type do not automatically violate the standard; however, disclosures in less than 8-point type would likely be too small to satisfy the standard.
- Provide wide margins and ample line spacing
- Use boldface or italics for key words; and
- In a document that combines disclosures with other information, use distinctive type size, style, and graphic devices, such as shading or sidebars, to call attention to the disclosures.

In addition, the proposals strongly recommend segregation of required disclosures:

> Except as otherwise provided, the clear and conspicuous standard does not prohibit adding to the required disclosures such items as contractual provisions, explanations of contract terms, state disclosures, and translations; or sending promotional material with the required disclosures. However, the presence of this other information may be a factor in determining whether the clear and conspicuous standard is met.

## Overview

ABA strongly agrees with the principle that the disclosures required in the various consumer protection regulations should be clear and conspicuous. Indeed, that has been the standard for decades, a standard that appears generally to be working well. We have heard no complaints or outcry that current disclosures are not clear and conspicuous or that they are unsatisfactory, and the Board presents no such evidence. The intention to make the meaning of "clear and conspicuous" consistent throughout the consumer protection regulations, on the surface, also appears sensible and attractive. However, when applied practically, the proposals are clearly much more far reaching than they appear and represent a drastic change in the approach of the regulations: the proposals basically transfer the responsibility of defining "clear and conspicuous" from the Board to the courts, without furthering the goal of making disclosures clear and conspicuous.

The cost of the proposals cannot be overstated. The cost of initial compliance itself is staggering. In effect, the proposals, if adopted, would require financial institutions to dismantle existing compliance systems that are based on decades of regulations and court interpretations, and recreate different systems that in the end will produce little if any improvement in consumer understanding. Every consumer related document, every form, account agreement, statement etc., in the financial institution will have to be reviewed and likely revised, including marketing materials. Changes will have to be made not just to forms, but to software systems, websites, telephone scripts, and advertisements. Staff will have to be trained, training and auditing manuals revised. Even then, the financial institution will not know for certain whether it complies until challenged by the courts or examiners. Continuing costs include substantially increased document production and mailing costs due to lengthier documents, as well as the costs related to risk management associated with lawsuits.

That the Board is proposing such drastic and comprehensive compliance modifications while it is requesting suggestions on how to reduce regulatory burden on the very same regulations is puzzling. One banker's cogent suggestion to control regulatory burden was, "To start, just hold still." Adopting these proposals would go in the opposite direction.

Other costs relate to the courts. The "examples" in the proposals will serve as a roadmap to challenge compliance in the courts, encouraging wasteful litigation. The challenges to compliance will come not only in expensive class action suits, but also raised in routine collection suits. The risks and uncertainty associated with potential court decisions could raise safety and soundness implications.

Beyond the massive costs, the proposals are simply unworkable and cannot be fixed. There are disclosures after disclosures, in regulation after regulation, that show why the proposed "examples" do not work. In many cases, rather than assisting consumers in understanding disclosures, they will confuse or misguide consumers or cause useful, but unrequired information to be omitted.

They also do not work because of their subjectivity. Debate could rage for years over whether a particular word is an "everyday" word in a particular part of the country. Reasonable minds could always argue that a sentence could be shorter. And we can expect challenges that disclosures use legal and technical terms: the disclosures, after all, deal with legal and technical matters. But they will still be challenged and some court or courts will find them noncompliant. The qualifiers that the lists are only "examples" and are required "whenever possible," offer little comfort when the financial institution is confronted in court or by examiners who simply ignore those qualifiers and interpret the "examples" as requirements. They are illusory safeharbors in the practical world.

Finally, the Board offers no evidence that the current standard does not work. Indeed, it is baffling that it proposes to model the Commentaries to the consumer protection regulations after Regulation P's Commentary when that that regulation is under review because its disclosures are considered deficient. Moreover, the disclosures of Regulation P are in nature different from those in the consumer protection regulations. Regulation P addresses a single concept, an institution's *policy*, that is applied throughout the organization. In contrast, the consumer protection regulations address numerous and complicated terms and information, often specific to individual transactions and accounts. Moreover, the civil liability contained in the consumer protection regulations and absent in Regulation P adds considerable pressure to compliance and litigation costs and risks.

## *The proposal will impose significant compliance costs.*

If they are adopted, financial institutions will have to review every single consumer financial product document and advertisement and catalog those containing required disclosures. This applies to every consumer financial product and contract. For every bank it means reviewing hundreds of agreements, forms, statements, webpages, and telephone scripts, even cassettes for blind people.

Once identified, required disclosures will have to be segregated from non-required disclosures and analyzed and revised. The revision effort will be time-consuming and expensive as staff and lawyers debate what are "everyday words," and whether "legal" and "technical" terms can be changed without altering their legal effect. We can expect that financial institutions would have to pay for focus groups and hire linguists or other similar specialists to analyze readability. In fact, this is what occurred with the Regulation P disclosures. And that was a single disclosure.

Once new terminology is decided, the financial institutions must endeavor to format the disclosures and address software demands, not an insignificant task. Software programs will have to be modified and in many places replaced: they will no longer be usable as the disclosures will no longer fit in the original fields. Old stock will have to be replaced.

In addition, there are the initial and continuing training costs for a long list of staff: compliance officers, legal staff, lending officers, auditors, branch and teller staff, etc.

It is difficult to estimate the costs of the change. One banker reported that when he requested estimates from his bank's staff, they responded it was impossible to estimate because they cannot fathom the depth and complexity of the proposals.

Regulation P, from which the proposals are drawn, requires disclosures of a much simpler, more straightforward nature than those of the consumer protection regulations, but the articulation and format challenges imposed by Regulation P were nevertheless significant. One large institution reported that after it had determined its Regulation P privacy policy, it took between six and eight months of dedicated staff to put the policy into words and format that it believed would comply with Regulation P. Compared to the regulations under consideration, the Regulation P message was fairly simple. Moreover, there was not the added pressure and burden of potential civil liability that is attached to the regulations under consideration.

Even the amendments to Regulation Z of several years ago, imposing font and other requirements on credit card solicitation disclosure boxes, were costly. The same large bank used six months of dedicated staff just to make the needed font and other changes, and those changes were far more modest than what is proposed.

For smaller institutions, the challenge is more daunting. In small institutions, bank staff wear multiple hats. The compliance officers often have other responsibilities beyond compliance. They will be less able to manage those other important functions if they are compelled to commit to retooling their entire compliance programs and making wholesale revisions to their consumer account disclosures. Ultimately, the costs of compliance, whether large or small institution, add to the consumers' price.

### *Courts will add to the costs.*

***The proposals will be a magnet for lawsuits.***

That the proposals, if adopted, will spawn class actions suits should not be dismissed as an industry overreaction. Monitoring and managing class action suits are a critical aspect of risk management for financial institutions based on real cases. The proposals will significantly impact this critical risk management by multiplying the potential for litigation costs. The cost is not just measured by losses on a particular case, but by the costs of avoiding, settling, and defending such suits.

The proposals will provoke litigation by providing a clear basis for challenging compliance. The proposals offer the illusion of objectivity and specificity, but, in fact, are subjective, and therefore subject to endless potential litigation. Currently whether disclosures are "clear and conspicuous" is a question of fact based on an analysis of the specific disclosure. The proposals, however, apply general theories to all disclosures, whether or not they are appropriate for that particular disclosure. Whether the disclosures are clear and conspicuous will no longer be a question of looking at that particular disclosure, but whether that particular disclosure complied with all the "examples" enumerated in the commentary: Bullet points could have been inserted here, headings inserted there. This is a technical or legal term, not a "concrete" or "everyday" term. This single sentence could have been two sentences. The margins were not wide enough. The advertisement did not "call attention to the nature and significance of the information." The list goes on. The consequence is that all disclosures become fodder for plaintiff's attorneys and vulnerable to the second-guessing of countless courts.

The Board attempts to offer flexibility and safety in the proposals with qualifiers such as "whenever possible," "do not automatically violate the standard," and "the standard does not prohibit, " but those safeharbors are illusory. Given experience and history, it would be risky for a financial institution to assume that a court or examiner will not find violations for failing to comply with one of the "examples" or that a court or examiner will have a different opinion about whether a particular disclosure can be improved based on the "examples."

***Collection suits will also create risk.***

The risks and costs related to courts are not limited to class action suits driven by the reward of attorneys fees and statutory damages. The issue is also relevant with regard to collection efforts.

The challenge to comply with the proposal will arise in the course of collection suits, for example, in local courts all over the country. The defense will argue that the disclosures did not comply with one or more of the "examples." The court, unfamiliar with Regulation Z or general financial terms, will read the examples and documents literally and agree with the defense. Word then spreads that 1) the particular documents of that institution are assailable; and 2) defendants should use the "examples" in the Commentaries in any collection suit to avoid repayment. Moreover, challenges to Regulation Z frequently arise in an emotional context, e.g., the borrower has defaulted and may lose a home. Sympathy for the consumer in such cases can distract courts from objectivity and reasoned Regulation Z analysis. The decisions may be based on the individual outcome, rather than the integrity of the regulation or the impact on the general public or industry. The proposals will give additional impetus for such decisions.

***The proposals are unworkable and cannot be fixed and they make courts arbiters of "clear and conspicuous."***

The "examples" listed in the proposal are appealing in concept, but in practice are not workable in the context of the majority of the specific requirements of the consumer protection regulations. Simply perusing any of the regulations and applying the "examples" to required disclosures will produce a multitude of questions about how to comply. As noted earlier, the "examples" create a lot of risky subjectivity. Rather than providing certainty and guidance, the regulations will leave a vacuum and invite challenge. In effect, the proposals shift the responsibility for rulemaking from the Board to the courts.

Financial institutions will never be certain whether they comply because ***every*** disclosure can ***always*** be challenged by citing one or all of the "examples." The permutations of how financial institutions may or may not comply are endless when the proposed lists are applied to the many required disclosures of the consumer protection regulations, too lengthy to list. Decades of interpretations and guidance will become meaningless, to be replaced by new rounds of expensive court decisions.

## *In many cases, application of the proposed "examples" will not improve consumer understanding.*

The examples, in many cases, will not help consumers and in fact may leave them with less information that is useful. For example, the proposal provides that the required disclosures should be segregated. But this will result in illogically arranged information that consumers will find hard to follow and absorb. Related information will get separated and thus ignored. For example, balance information required under Regulation DD would be separated from a notice that the balance contributes to the "combined balance" of all accounts that helps customers avoid fees. The examples are numerous.

Moreover, useful but unrequired information may well be omitted in order to fit the required disclosures on a single page. If fonts are increased to the 12 point type as proposed, financial institutions will delete useful, but unrequired information from account statements to save space. Statements would no longer include typical tables that assist customers in balancing their checking account and “coupons” for disputing transactions. Rather than providing dispute rights on the back of the periodic statement, some financial institutions will send an annual notice, which invariably cannot be found when the occasion for its use arises.

### *Regulation P is different from the consumer protection regulations.*

It is perplexing that the Board is choosing to follow the standard provided in Regulation P when that regulation is under review, apparently because it needs improvement. However, even if the examples are appropriate for Regulation P, they are not appropriate for the consumer protection regulations.

The privacy policy disclosures of Regulation P and those of the typical consumer protection regulations are inherently different. Regulation P requires financial institutions to convey an institution’s general policy on a single matter that applies across the institution to all products. In contrast, the disclosures of the consumer protection regulations convey complex, sometimes abstract, and often detailed terms that are usually unique to that transaction or account. In many cases, legal and technical terms are necessary: legal language is essential in order for the agreement to be enforceable, technical language in order to be accurate, as the regulations require. “Everyday” or “concrete” terms will change their meaning or leave ambiguity.

Moreover, the civil liability applied to consumer protection regulations that is not applied to Regulation P changes the complexion of the analysis. That an institution can be challenged in court, subject to costly statutory damages and attorneys’ fees, or that borrowers may be absolved from repayment responsibility puts a different pressure on disclosure drafting and design. Each word --- and even each space -- must be debated and weighed carefully.

## *OTHER PROVISIONS RELATED TO REGULATION Z*

***Section 226.2(b)(5).*** The Board proposes to add an interpretative rule of construction stating that where the word “amount” is used to describe a disclosure requirement, it refers to a numerical amount throughout Regulation Z. The proposed interpretation is intended to address a court decision regarding the disclosure of payments scheduled to repay a closed-end credit transaction. We agree with this new comment.

***Comment 15(a)(2)-1.*** This proposed comment would be revised to address situations where a creditor fails to provide the required right of rescission form or designate an address for sending the rescission notice. The proposed comment would provide that in such cases, if a consumer sends the notice to someone other than the creditor or assignee, such as a third-party loan servicer acting as the creditor's agent, the consumer's notice of rescission may be effective if, under the applicable state law, delivery to that person would be deemed to constitute delivery to the creditor or assignee.

We suggest that the proposed comment be revised to make the notice effective if the consumer sends it to the person or address to whom payments are to be sent. Connecting the issue to state laws creates uncertainty, confusion, and complexity. Moreover, sending it to the person or address to whom payments are to be sent is logical for the consumer.

***Request for Information Regarding Debt Cancellation and Debt Suspension Agreements.*** Please refer to the letter of the American Bankers Insurance Association, a wholly owned ABA subsidiary which addresses this issue in depth.

## *CONCLUSION*

ABA appreciates the Board's intention to facilitate compliance and improve the disclosures required by the various consumer protection regulations. However, we stress that the proposal to apply the "clear and conspicuous" examples of Regulation P to the consumer protection regulations is simply unworkable. Accordingly, they should be withdrawn. The costs of dismantling and rebuilding the existing compliance systems are huge. Moreover, even after those expenses and painstaking debate on how to comply, financial institutions are still vulnerable: creative attorneys will only have to cite one of the proposed "examples" to find error. Courts, rather than the Board, will be interpreting the statute and inconsistent determinations will create confusion. Finally, the proposals are not suitable for the types of account and transactions covered by the regulations. Rather than enhancing disclosures, in many cases, they will deprive consumers of logical and complete information.

We appreciate the opportunity to comment on this important matter and would be pleased to provide additional information.

Sincerely,

Edward L.Yingling